IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1973

No. 73-5265

HENRY A. KOKOSZKA, Bankrupt,

Petitioner,

v.

RICHARD BELFORD, Trustee in Bankruptcy of the Estate of Henry A. Kokoszka, Bankrupt,

Respondent.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

BRIEF OF AMICUS CURIAE IN SUPPORT OF THE JUDGMENT BELOW

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INTEREST OF AMICUS CURIAE

This brief is submitted pursuant to the Court's invitation of March 4, 1974 to the undersigned to brief and argue this case as *Amicus Curiae* in support of the judgment below.

PRELIMINARY STATEMENT

Respondent adopts the material in Petitioner's brief under the headings "OPINIONS BELOW", "JURISDICTION", "STATUTES INVOLVED" and "STATEMENT OF THE CASE".

QUESTIONS PRESENTED

1. Is an income tax refund due Petitioner-bankrupt "property" which passes to the trustee under Section 70a(5) of the Bankruptcy Act?

2. If the income tax refund is "property" within the meaning of Section 70a(5) of the Bankruptcy Act, do the garnishment provisions of the Consumer Credit Protection Act preclude the bankruptcy trustee from taking the entire refund?

SUMMARY OF ARGUMENT

I. and II. Legislative history and relevant decisions of this Court support a broad interpretation of what is "property" within the meaning and scope of Section 70a(5) of the Bankruptcy Act. The Bankruptcy Act permits the bankrupt to withhold from his creditors those assets which are exempt under (1) the laws of the state where he resides and (2) statutes of the United States. The State of Connecticut does not exempt an income tax refund from the claims of creditors. Likewise, there is no Federal statue providing for such an exemption.

The "fresh start" doctrine embodies the benefits flowing to the debtor from bankruptcy – relief from

the obligation of pre-bankruptcy debts, retention of exempt property provided in Section 6 of the Act, and freedom to accumulate future wealth. None of the relevant cases decide, or even suggest, that a "fresh start" permits a bankrupt to withhold from the trustee what would otherwise be "property" unless the asset is exempt or some right is provided in Section 70a – the bankrupt can acquire his life insurance policy from the trustee by paying the cash surrender value. Moreover, *Legg v. St. John*, 296 U.S. 489 (1936), holds that the "fresh start" doctrine is inapplicable to a situation in principle the same as the one presented before this Court.

An income tax refund which was due as of the date of bankruptcy is "property" within the meaning of Section 70a(5) of the Bankruptcy Act. *Segal v. Rochelle*, 382 U.S. 375 (1965), involved a similar issue and this Court determined that income tax refunds relating to taxable events occurring before bankruptcy were "sufficiently rooted in pre-bankruptcy past and so little entangled with the bankrupts' ability to make an unencumbered fresh start that it should be regarded as "property" under §70a(5)". The decision in *Lines v. Frederick*, 400 U.S. 18 (1970), is inapplicable and distinguishable because vacation and layoff pay accrued but unpaid at the time of bankruptcy, was determined by this Court to be "future wages". One of the bankrupts could collect the sum either during the annual period when his employer shut down the plant, or on termination of his employment. The other bankrupt could draw it either on termination or under a conventional voluntary vacation plan. According to this Court, without the layoff or vacation pay, the bankrupts would not achieve the "new opportunity in

life and [the] clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt".

III. Petitioner requests this Court to amend judicially the present Bankruptcy Act by (1) determining that an income tax refund is not "property" within the meaning of Section 70a(5) or (2) ruling that an income tax refund is "exempt", contrary to Section 6 of the Bankruptcy Act and the laws of the State of Connecticut. Furthermore, the proposed Bankruptcy Act of the Commission on the Bankruptcy Laws of the United States, pending in the Congress, offers a more preferable and traditional method of amending the Bankruptcy Act.

IV. The Consumer Credit Protection Act ("CCPA") does not preclude the trustee from taking the entire refund within the bankruptcy estate. The legislative history of the CCPA clearly indicates an intent to correct problems and abuses through garnishment of an employee's wages outside a bankruptcy proceeding. An income tax refund is not "earnings" or "disposable earnings" within the definitions of Section 1672(a) and (b) of the CCPA. Moreover, the trustee's taking of the refund is not "garnishment" within the definition of Section 1672(c) of the CCPA.

ARGUMENT

I.

THE LEGISLATIVE HISTORY OF SECTION 70a(5) OF THE BANKRUPTCY ACT MANIFESTS AN INTENT BY CONGRESS TO GIVE THE TERM "PROPERTY" A BROAD DEFINITION AND CONGRESS INTENDED TO PROTECT THE INTERESTS OF THE BANKRUPT THROUGH SECTION 6 OF THE BANKRUPTCY ACT.

A. Legislative Background of Section 70a(5) of the Bankruptcy Act.

In order to gain a proper perspective of the meaning of "property" as the word is used in Section 70a of the Bankruptcy Act, one must journey through the history of bankruptcy legislation in the United States. The Bankruptcy Act of 1800 represented the nation's first Federal bankruptcy legislation.[1] Among other provisions, the Act provided that upon a declaration that the debtor was bankrupt, duly appointed commissioners of the bankrupt were empowered to take into their possession "all the estate, real and personal, of every nature and description to which the said bankrupt may be entitled, either in law or equity, in any manner whatsoever", excluding certain specified Federal exemptions of "necessary wearing apparel" and "necessary beds and bedding".[2] The estate of the bankrupt also included all debts due to such bankrupt or to any other person for the bankrupt's use or benefit.[3] If any estate,

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[1] 4A Collier, Bankruptcy, P. 23, §70.02[2](14th Ed. 1971) (hereinafter called "Collier").

[2] Act of April 4, 1800, §5, 2 Stat. 19. Each of the United States Bankruptcy Acts is set forth in 10 Collier, Appendix.

[3] *Id.* §13.

real or personal, descended, reverted to, or became vested in any person after being declared a bankrupt and prior to that person obtaining a certificate of discharge, such estate vested in the commissioners.[4] This Act was repealed in 1803.

The next Federal bankruptcy statute was the Bankruptcy Act of 1841.[5] Like its predecessor, the Act of 1841 broadly described the assets of the bankrupt which vested in the trustee (termed the "assignee") as "all the property and rights of property, of every name and nature, and whether real, personal, or mixed".[6] Specified household articles and wearing apparel were exempted, along with other articles not to exceed the sum of $300.00 in the discretion of the assignee.[7] There was no definition of the term "property". This Act also was shortlived and was repealed in 1843. The next bankruptcy act – the Act of 1867 – likewise failed to define "property" but described the "property" and "estate" of the bankrupt in similarly broad terms.[8] The Act of 1867 was repealed in 1878.

In 1898, the present Section 70a was enacted. Entitled "title to Property", Section 70a, as enacted,[9] provided generally that the trustee of the estate of a bankrupt was vested by operation of law with the title of the bankrupt, as of the date he was adjudged a

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[4] *Id.* §50.

[5] Act of August 19, 1841, 5 Stat. 440.

[6] *Id.* §3.

[7] *Id.*

[8] Act of March 2, 1867, §15, C. 176, 14 Stat. 517.

[9] Act of July 1, 1898, §70a, C. 541, 30 Stat. 544, *as amended,* 11 U.S.C. §110.

bankrupt, to all assets and property as specified thereafter. The relevant portion of the provision, subsection (5), described the bankrupt's estate as all "property which prior to the filing of the petition [the bankrupt] could by any means have transferred or which might have been levied upon and sold under judicial process against him."[10] Again, there was no definition of the term "property".

Section 70 was substantially amended by the Act of 1938, popularly known as the Chandler Act.[11] Specifically the wording of Section 70a was modified to provide that the trustee of the estate was vested by operation of law with the title of the bankrupt as of the date of the filing of the petition in bankruptcy.[12] Under subsection (5) of Section 70a, the trustee was vested with all "property, *including rights of action*, which prior to the filing of the petition [the bankrupt] could by any means have transferred or which might have been levied upon and sold under judicial process against him." (emphasis added)[13] There were other changes relating to: (1) property rights which vested within six months after bankruptcy through bequest, devise, or inheritance, and (ii) property in which the bankrupt had on the date of bankruptcy an estate or an interest by the entirety.[14]

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[10] *Id.*, subsection 5.

[11] Act of June 22, 1938, C. 575, 52 Stat. 879, *amending*, 11 U.S.C. §1 *et seq.*

[12] *Id.* §1; The Act of 1898 provided that the property vested "as of the date [the bankrupt] was adjudged a bankrupt".

[13] *Id.*

[14] *Id.*

Section 70a was further amended in 1952 to vest in the trustee by operation of law all property of the bankrupt wherever located.[15] Otherwise, Section 70a has remained unchanged since the Chandler Act became law.

The history of bankruptcy legislation indicates that Congress never attempted to define specifically the word "property" in the context of bankruptcy legislation. Past bankruptcy legislation does reveal, however, that Congress intended the word to have a very broad defintion, so as to effect a transfer of all of the bankrupt's assets, whether in the form of tangible goods or rights, to the trustee for distribution to creditors.[16] In fact, "property" first appeared in the 1841 Act as part of a phrase "property of every name and nature".[17] Section 70a of the present Act provides creditors with their primary remedy under the Act and, in that sense, the Section can be said to be creditor oriented.[18] Had Congress intended to withhold certain

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[15]Act of July 7, 1952, §23, C. 579, 66 Stat. 429, *amending*, 11 U.S.C. §1 *et seq.*

[16]For general background and the legislative history of bankruptcy laws in the United States, see 1 *Collier*, Pars. 0.01 through 0.08 and Charles Warren, *Bankruptcy in United States History*, Harvard University Press, 1935; see also Comment, *Aspects of the Chandler Bill to Amend the Bankruptcy Act*, 4 University of Chicago L.R. 369 (1936-37); Comment, *Bankruptcy Exemptions: Critique and Suggestions*, 68 Yale L.J. 1459 (1959); and Comment, *Bankruptcy Exemptions: A Full Circle Back to the Act of 1800?* 53 Cornell L.R. 663 (1968).

[17]Note 5, *supra.*

[18]In this sense, Section 70 can be contrasted with the "exemption" (Section 6) and "discharge" (Section 14) sections of the Act which provide protection to the bankrupt.

property interests from creditors –as it did by creating exemptions – one would imagine that these interests would be specifically enumerated.

Other forms of legislative history are less helpful in ascertaining the scope of Section 70a. Specifically, Congress made no effort in legislative reports or debates to detail the types of interests or rights which should be included within the term "property". Congressional debate on the present Bankruptcy Act, however, at least indicates a Congressional intent to preserve in that Act the inclusive definition given to "property" in earlier acts. Senate Bill 1035,[19] which became the Bankruptcy Act of 1898, was reported from Committee in the House of Representatives by Representative Henderson of Iowa, Chairman of the Committee on the Judiciary. In explaining Section 70 under the general heading, "The Estate", Representative Henderson noted that "property *of every kind and description* which prior to the filing of the petition might by any means have been transferred by the bankrupt or which might have been levied upon and sold under judicial process against him, will vest in the trustee". (emphasis added)[20]

In conclusion, the legislative history of bankruptcy statutes from the Bankruptcy Act of 1800 to the most recent amendments of the present Act does not address the precise question of whether a tax refund due a bankrupt is "property" within the meaning of §70a(5). The Federal income tax laws did not provide for

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[19]55 Cong., 2d Sess. (1897).

[20]31 Cong. Rec. 1788 (1898) (Remarks of Representative Henderson).

withholding of income taxes until 1943,[21] and since 1943, as indicated above, there has been virtually no legislation dealing with Section 70a. One thing is clear, however. The word – "property" – within the context of Section 70a and preceding bankruptcy acts has been given as broad a meaning as possible.

B. Legislative Background of Section 6 of the Bankruptcy Act.

Congress' intent to give the term "property" a very broad construction becomes more apparent when Section 70a is read in conjunction with Section 6 of the Bankruptcy Act, – entitled "Exemptions of Bankrupts".[22] Section 70a is essentially a creditor-oriented provision securing to the creditors the property of the bankrupt. The bankrupt's interests are then brought to bear through Section 6.

The purpose of Section 6 is to exempt certain property of the bankrupt from seizure by his creditors, giving him the property exemptions in force in his domiciliary state, together with any applicable Federal exemptions. The protective effect of Section 6 is reflected in Section 70a of the Act, which excludes exempt property from the bankrupt's estate.

The history of the Bankruptcy Act and its predecessor acts make clear that Congress included Section 6 in the Act to assure that bankrupts would have an opportunity to make a "fresh start",

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[21]Current Tax Payment Act of 1943, 1943 Cum. Bull. 1239; H. Rept. No. 401, 78 Cong., 1st Sess., 1943 Cum. Bull. 1283; S. Rept. No. 221, 78th Cong., 1st Sess., 1943 Cum. Bull. 1314.

[22]11 U.S.C. §24.

unencumbered by their prior debts. Congress decided that this purpose could best be achieved through incorporation of the individual exemption laws of the various states.

This purpose of Section 6 becomes obvious when the Section is read in historical context. Each of the United States bankruptcy statutes, beginning with the Bankruptcy Act of 1800, made some provision for protecting certain items of property from seizure by creditors.

As previously noted, the Act of 1800, and the subsequent Bankruptcy Act of 1841, dealt with exemptions by specifying items of property which could be retained by the bankrupt. No reference was made to state law. Both of these acts, however, had very short duration[23] and during the interim periods when no Federal bankruptcy statutes were in effect, the individual states adopted their own insolvency laws to deal with creditor-debtor problems.[24] These statutes generally listed homestead and other real and personal property which were exempt from seizure by creditors. These listings varied widely from state to state.[25]

In the 1860's, following the financial panic of 1857, pressure again mounted for a Federal bankruptcy statute. In order to gain support from western states, which generally had adopted broad exemptions in their insolvency laws, Congress incorporated state exemptions within the context of a Federal bankruptcy statute –

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[23]As previously noted, the Bankruptcy Act of 1800 was repealed in 1803 and the Bankruptcy Act of 1841 was repealed in 1843.

[24]Warren, *supra*, noted 16, at 91.

[25]*Id.* at 100.

which became the Bankruptcy Act of 1867.[26] This same concept was repeated when Section 6 was adopted in the present Bankruptcy Act of 1898.

A great deal of Congressional concern was expressed in 1867 and 1898 that the Acts, by incorporating state exemptions, would not meet the constitutional requirements of uniformity.[27] This concern was apparent in the speech of Representative Henderson, Chairman of the Committee on the Judiciary, when he opened the debate on S.B. 1035[28] which was enacted to become the Bankruptcy Act of 1898, as follows:

> "The exemptions of the bankrupt will be allowed as prescribed by the State laws in force at the time of the filing of the petition in the State wherein he had his domicile for six months, or the greater portion thereof, immediately preceding the filing of the petition.
>
> "It has been suggested that since the exemption as provided by each of the States is different from those provided by every other State, a law which does not interfere with them may be unconstitutional because not uniform. There are two replies to his suggestion: The first is that the last bankruptcy law recognized the validity of the exemption of the State laws as of a certain date and notwithstanding such provision was held to be constitutional by the courts.
>
> "The second reply is, that the proposed law does not undertake to confirm, or to in any sense

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[26]The Bankruptcy Act of 1867 was repealed in 1878.

[27]The Supreme Court upheld the constitutionality of Section 6 in *Hanover National Bank v. Moyses*, 186 U.S. 181 (1901).

[28]Note 19, *supra*.

enact, the laws as in force in the several States, but simply refuses to interfere with such laws or to make any provision for providing other exemptions for bankrupts. If the law should be criticised in this, that it does not provide a uniform exemption different from the States or undertake to exercise any control over State legislation upon that subject, the reply is that it is not necessary for it to do so as a legal proposition, and that it is impracticable for it to do so as a matter of policy.

"The needs of the poor man in each of the States is different from the needs of poor men similarly situated in other States – that is to say, in order for an insolvent debtor to protect his family from want in, say Florida, he must have household belongings of quite a different character than would be necessary if he was a resident of, say, Maine or Oregon. If it would undertake to provide a uniform exemption in money value, the same difficulties would be encountered.

"That is to say, the amount that would be necessary to provide the modest belongings which the insolvent debtor should have for the needed protection of his family in, say, Connecticut, would be very much less than would be required for the same debtor to make like provision if he were a citizen of Montana or Texas.

"In view of all which it has been thought advisable by the committee not to endeavor to utilize the bankruptcy law as a means of correcting State legislation on this important subject. Those who may fear that the bill on this account is

unconstitutional may calm their fears, as there is not the slightest danger in this respect."[29]

The above remarks, appear from seeking to appease those members of Congress who felt this section was unconstitutional, give broad insight into Congress' view of the purpose of Section 6. Most importantly, Representative Henderson's remarks establish that Congress intended that the state exemptions authorized in Section 6 be the only exemptions available to bankrupts under the Act, i.e., Congress "refuses . . . to make any provision for providing other exemptions for bankrupts". Congress, for policy reasons, left to the individual states the task of determining how much and what type of property should be retained by the bankrupt, and thereby reconciled the debtor and creditor interests inherent in this decision.

The Chandler Act of 1938[30], which materially amended the Act of 1898, made no basic change in Section 6. An amendment was adopted which added to Section 6 any exemption "prescribed by the laws of the United States". This amendment carried over to the Act the exemptions for pensions, soldiers' bonuses, and other payments which were then contained in other Federal statutes.[31] Provisions were also added to Section 6 which (1) provided that no exemption should be taken out of fraudulently transferred property

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[29]31 Cong. Rec. 1787 (1898) (Remarks of Representative Henderson).

[30]Note 11, *supra.*

[31]Remarks of Mr. Adair, Member, National Bankruptcy Committee, Hearings on H.R. 6439, *Revision of the Bankruptcy Act,* before the House Committee, June 1-9, 1937.

recovered by the estate and (2) clarified the definition of domicile for the bankrupt. No other Federal exemption, general or otherwise, was added to the Act.

The 1938 Chandler Act was written by a group known as the National Bankruptcy Conference in conjunction with the House Committee on the Judiciary.[32] The following remarks of one of the Conference members, Mr. Jacob I. Weinstein, during the 1937 hearings on the legislation, are interesting insofar as they express why the Conference decided not to adopt national exemptions in place of the state exemptions embodied in Section 6:

> "The National Conference has given this subject careful study. At one of its early sessions it considered the advisability, for the purposes of the Bankruptcy Act, either establishing an absolute uniformity of exemptions in disregarding the varying State laws or of permitting the present diversity of exemptions to remain, but with a limitation upon the maximum amount of such exemptions. It found, however, that the subject necessarily involved a study of the exemption statutes of each State and of the State decisions thereunder, and of the local conditions and circumstances which give rise to these varying exemption allowances. After a cursory examination of the various exemption laws it being apparent to us that in the present economic condition of the country, it would be most inadvisable to attempt any changes. It also occurred to us that any limitation on the present exemption allowed under the bankruptcy law would be met with vigorous political opposition, particularly from the repre-

[32]H. Rept. No. 1409, 75th Cong., 1st Sess., 2-3 (1937).

sentatives of farmer States. Therefore, we abandoned for the present the drafting of a uniform exemption provision."[33]

In conclusion, the Congressional intent first expressed by Congress in 1898 when it enacted Section 6 is still embodied in that Section today. State exemptions[34] are the exclusive means by which Congress intended to protect the property of bankrupts from seizure by creditors.

In prior decisions, this Court has itself recognized that Congress decided to rely on state exemption laws rather than establishing general Federal exemptions. In *Holden v. Stratton*, 198 U.S. 202 (1905), the Court had occasion to reconcile the exemption provisions of Section 6 with the provisions of Section 70a(5) which specifically dealt with the disposition of life insurance policies. The question in that case was whether a life insurance policy, admittedly exempt under Washington state law, passed to the bankrupt by virtue of the state exemption or to the trustee by virtue of the specific proviso in Section 70a(5) dealing with life insurance. The Court held that Section 6 qualified the entire Section 70a, including the portion dealing with life insurance, and the policy passed to the bankrupt. In so holding, the Court noted that "[i]t has always been the policy of Congress, both in general legislation and in

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[33]Hearing on H.R. 6439, note 31, *supra* at 388. Mr. Weinstein introduced with his remarks a table comparing the various state property exemptions then in force.

[34]As noted, the Chandler Act of 1938 added to Section 6 any exemption "prescribed by the laws of the United States". See note 31, *supra*.

bankrupt acts, to recognize and give effect to the state exemption laws". 198 U.S. at 213-214.

The Court's recognition of state exemptions as the exclusive means by which bankrupts were allowed to retain some property was set forth in *Hanover National Bank v. Moyses*, 186 U.S. 181 (1901). In that case, the Court was faced with the contention that Section 6, by incorporating various state exemptions into the Act, rendered the 1898 Act unconstitutional as not being "uniform" under the Constitution. The Court rejected this argument stating that the Act was uniform "when the trustee takes in each state whatever would have been available to the creditors if the bankrupt law had not been passed". 186 U.S. at 190. This quote implicitly recognized the absence of any general Federal exemptions under the Act.

In sum, Congress' decision to adopt state exemptions within the context of the Bankruptcy Act represents an obvious compromise between debtor and creditor interests. On the one hand, such exemptions represent Congressional intent to preserve certain items of property for the bankrupt. On the other hand, the very existence of exemptions reaffirms the concept that all property *not* exempt is to be vested in the trustee for distribution to creditors.

II.

A TAX REFUND IS "PROPERTY" WITHIN THE MEANING OF SECTION 70a(5) OF THE BANKRUPTCY ACT

A. The development of the "fresh start" doctrine prior to *Segal v. Rochelle* and *Lines v. Frederick*.

In *Wetmore v. Markoe*, 196 U.S. 68 (1904), this Court held that alimony arrears awarded to a wife

against her former husband for support of herself and their children in accordance with a final decree of absolute divorce was not a provable debt barred by discharge in bankruptcy. After a discussion of the merits of the case, the Court made the following observation (at 77):

> "... Systems of bankruptcy are designed to relieve the honest debtor from the weight of indebtedness which has become oppressive and to permit him to have a *fresh start* in business or commercial life, freed from the obligation and responsibilities which may have resulted from business misfortunes. Unless positively required by direct enactment the courts should not presume a design upon the part of Congress in relieving the unfortunate debtor to make the law a means of avoiding enforcement of the obligation, moral and legal, devolved upon the husband to support his wife and to maintain and educate his children." (Emphasis added.)

The "fresh start" sanctioned by this early decision was to relieve a debtor from past debts which were dischargeable in bankruptcy. It is submitted that this is the very reason why the Petitioner, like other persons who are financially distressed, file for bankruptcy.

In *Burlingham v. Crouse*, 228 U.S. 459 (1913) a proviso of Section 70a of the Bankruptcy Act was interpreted to permit a bankrupt to retain a life insurance policy free from his creditors after he paid to the trustee the cash surrender value (which is all that could have been realized by the trustee for the creditors). The Court also considered the fresh start given the debtor as follows (at 473):

> "... It is the twofold purpose of the Bankruptcy Act to convert the estate of the bankrupt into

> cash and distribute it among creditors and then to give the bankrupt a *fresh start* with such exemptions and rights as the statute left untouched ... We think it was the purpose of Congress to pass to the trustee that sum which was available to the bankrupt at the time of bankruptcy, as a cash asset, otherwise to leave to the insured the benefit of his life insurance." (Emphasis added.)

In this context, a fresh start meant leaving the bankrupt with exempt property and the right to redeem his insurance policies under the proviso of Section 70a.

The Court decided that a discharge in bankruptcy covered the express obligation of a bankrupt's indemnification of his surety for any loss sustained upon a failure to perform a building contract. *Williams v. U. S. Fidelity Co.*, 236 U.S. 549 (1915). Even though the surety did not sustain the loss and pay the damages until after the bankruptcy petition had been filed, the indebtedness was discharged. In reaching this conclusion, the Court reasoned (at 554-555):

> "It is the purpose of the Bankruptcy Act to convert the assets of the bankrupt into cash for distribution among creditors and then to relieve the honest debtor from the weight of oppressive indebtedness and permit him to *start fresh* free from the obligation and responsibilities consequent upon business misfortunes. *Wetmore v. Markoe*, 196 U.S. 68, 77; *Zavelo v. Reeves*, 227 U.S. 625, 629; *Burlingham v. Crouse*, 228 U.S. 459, 473." (Emphasis added.)

The application of the "fresh start" doctrine was also referred to as "a new opportunity in life" in *Stellwagen v. Clum*, 245 U.S. 605 (1918), as follows (at 617):

"The federal system of bankruptcy is designed not only to distribute the property of the debtor not by law exempted, farily and equally among his creditors, but as a main purpose of the act, intends to aid the unfortunate debtor by giving him a fresh start in life, free from debts, except of a certain character, after the property which he owned at the time of bankruptcy has been administered for the benefit of creditors. Our decisions lay great stress upon this feature of the law – as one not only of private but of great public interest in that it secures to the unfortunate debtor, who surrenders his property for distribution, a new opportunity in life."

When *Local Loan Co. v. Hunt*, 292 U.S. 234 (1934), was decided, there was ample precedent by this Court that a bankrupt should not be denied a "fresh start" or new opportunity in life subsequent to his bankruptcy. However, the "fresh start" or "new opportunity in life" accorded a bankrupt upon discharge, as the cases discussed herein suggest, is not to the detriment of his creditors. All of those decisions recognize that the debtor's fresh start is conditioned upon a transfer of the property which he owned at the time of bankruptcy. unless exempt, to the trustee for the benefit of creditors.

In *Local Loan Co., supra*, this Court ruled that a state court could not enforce an assignment of *future* wages that had been made by the bankrupt prior to filing a petition in bankruptcy. In an unanimous decision, this Court reasoned (pp. 244-245):

"One of the primary purposes of the bankruptcy act is to 'relieve the honest debtor from the weight of oppressive indebtedness and permit him to *start afresh* free from the obligations and responsibilities

consequent upon business misfortunes.' *Williams v. U.S. Fidelity & G. Co.*, 236 U.S. 549, 554-555. This purpose of the act has been again and again emphasized by the courts as being of public as well as private interest, in that it gives to the honest but unfortunate debtor who surrenders for distribution the property which he owns at the time of bankruptcy, *a new opportunity in life and a clear field for future effort*, unhampered by the pressure and discouragement of preexisting debt. *Stellwagen v. Clum*, 245 U.S. 605, 617; *Hanover National Bank v. Moyses, supra; Swarts v. Fourth National Bank*, 117 Fed. 1, 3; *United States v. Hammond*, 104 Fed. 862, 863; *Barton Bros. v. Texas Produce Co.*, 136 Fed. 355, 357; *Hardie v. Swafford Bros. Dry Goods Co.*, 165 Fed. 588, 591; *Gilbert v. Shouse*, 61 F.2d 398. . . . When a person assigns future wages, he, in effect, pledges his future earning power. . . . *The new opportunity in life and the clear field for future effort*, which it is the purpose of the bankruptcy act to afford the emancipated debtor, would be of little value to the wage earner if he were obliged to face the necessity of devoting the whole or a considerable portion of his earnings for an indefinite time in the future to the payment of indebtedness incurred prior to his bankruptcy." (Emphasis added.)

The Court determined that an assignment of future wages made prior to bankruptcy could not be sanctioned because such wages are not property of the debtor at the time of bankruptcy.[35] In fact, the assignment of future wages was given by the debtor as

[35] 292 U.S. at 243.

security for a loan made by Local Loan Company to the debtor prior to bankruptcy, and the indebtedness was discharged in the bankruptcy proceeding. Obviously, the enforcement of the assignment, sought by the loan company in a post bankruptcy proceeding, would have frustrated the fundamental purpose of a bankruptcy discharge, namely to give the debtor a fresh start unencumbered with debts and obligations in existence at the time of bankruptcy.

While the Court has cited the "fresh start" doctrine for the purpose of upholding the bankrupt's right to future wages and freedom from pre-bankruptcy debts and obligations, it refused to apply the doctrine, in a very difficult factual situation. In *Legg v. St. John*, 296 U.S. 489 (1936), it was decided that the vested right of a bankrupt to receive disability benefits in the future under a paid-up insurance contract passed to the trustee in bankruptcy. Mr. Justice Brandeis, speaking for a unanimous court, observed (pp. 495-496):

> "[T]he obligation of the company to pay disability benefits in the future is not after-acquired property. It is property which was acquired by Legg long before the adjudication, and fully paid for by premiums paid before the adjudication. Nor are the benefits payable after the adjudication in any sense future earnings. They are not the fruit of anything to be done by Legg after the adjudication. The right to secure disability benefits in the future does not differ from any other right acquired before adjudication to receive money thereafter. It is in essence an annuity purchased and paid for prior to the adjudication. Like other property, it passed to the Trustee, unless exempted by the law of the bankrupt's domicile. The principle declared in *Local Loan Co. v. Hunt*, 292 U.S. 234, is not applicable here."

The Court noted (at 496-497) that Tennessee, the debtor's domicile, did not exempt disability benefits. The reference to the *Local Loan Co.* decision deserves some comment. Presumably the debtor argued that he was being denied a fresh start and that the disability benefits consituted after-acquired property. It is important to understand the distinction which Justice Brandeis made. Like an income tax refund, the disability benefits "are not the fruit of anything to be done" after bankruptcy and such benefits do not "differ from any other right acquired before bankruptcy to receive money thereafter." No doubt, this was a difficult decision to render because the effect was to deprive a disabled person of benefits which he obviously needed to purchase food, clothing and shelter. However, it was the correct decision because the Bankruptcy Act, then and now, requires that result.

In sum, it is clear that the "fresh start" doctrine, discussed in cases interpreting certain provisions of the Bankruptcy Act, including Section 70a is simply a characterization of the benefits flowing to the debtor after bankruptcy-relief from the obligation of pre-bankruptcy debts, retention of exempt property provided in Section 6 of the Act, and freedom to accumulate future wealth.

It is likewise clear that none of these cases, in any way, supports Petitioner's claim to an income tax refund derived from pre-bankruptcy wages. The various discharge benefits discussed in the cases are of no help to Petitioner. In fact, the holding of *Legg* not considered in Petitioner's brief, interprets the "fresh start" doctrine as inapplicable to a stituation in principle the same as the one presented herein.

B. *Segal v. Rochelle* and *Lines v. Frederick*.

As a general rule, an income tax refund due the bankrupt at the time of filing the petition has been considered as property within the meaning of Section 70a(5), except for two recent decisions.[36] These exceptions are a result of two lower courts' application and interpretation of two recent cases decided by this Court.

In *Segal v. Rochelle*, 382 U. S. 375 (1965) this Court determined that a refund arising out of a business loss incurred prior to bankruptcy was property owned by the bankrupt and "transferable" at the time that the bankruptcy petition was filed and, therefore, passed to the trustee, in accordance with §70a(5) of the Bankruptcy Act. In late 1961, voluntary bankruptcy petitions were filed by Gerald Segal, Sam Segal and their business partnership. After the close of 1961 (the taxable year of the loss), the trustee applied for income tax refunds for both of the individual bankrupts.[37] The operating losses underlying the refunds had been incurred by the partnership during that part of 1961 which was prior to the filing of the petitions in bankruptcy.[38] The losses were carried back to the years

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[36]Calverly, *Income Tax Refunds Due Wage Earners*, J. of Nat. Assn. of Ref. in Bankruptcy 8, 10 (Jan. 1965). *Rev. Rul.* 72-38, 1972-2 CB 632; *In re Kingswood*, 343 F. Supp. 498, 504 (C.D. Calif. 1972). *In re Perry*, 225 F. Supp. 481 (N.D. Ohio 1963).

[37]Presumably, Applications for Tentative Carryback Adjustments (IRS Form 1139) were filed by the trustee. See Income Tax Regulations §1.6411-1(a) and (b).

[38]382 U.S. at 376.

1959 and 1960 to offset net income on which the Segals had both paid taxes.[39]

In examining Section 70a(5), the Court noted (at 379) that "[i]t is impossible to give any categorical definition to the word 'property' nor can we attach to it in certain relations the limitations which would be attached to it in others." According to the Court, the purposes of the Bankruptcy Act must govern whether an item is classed as "property."

The Court then reasoned (at 379):

> "[T]he main thrust of §70a(5) is to secure for creditors everything of value the bankrupt may possess in alienable or leviable form when he files his petition. To this end, the term 'property' has been construed most generously and an interest is not outside its reach because it is novel or contingent or because enjoyment must be postponed."

Further, the Court suggested (at 379):

> "However, limitations on the term do grow out of the purposes of the Act; one purpose which is highly prominent and is relevant in this case is to leave the bankrupt free after the date of his petition to accumulate new wealth in the future."

This purpose is illustrated by three examples: (1) future wages of the bankrupt; (2) inchoate right to a bequest or promised gift; and (3) an attorney's right to a contingent fee with respect to litigation pending at

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[39]The refunds to Gerald Segal were in the amounts of $283.07 and $1,608.21 for the years 1960 and 1959, respectively; and the refunds to Sam Segal for 1960 and 1959 were $505.63 and $1,839.41, respectively.

the date of bankruptcy.[40] In each of these examples, on the date of bankruptcy, the debtor had no right to the asset in issue, and it has been recognized as fundamental to the Bankruptcy Act that the debtor's assets acquired after bankruptcy are not subject to debts and obligations dischargeable in bankruptcy. See *Local Loan Co. v. Hunt, supra.* The holding of *Segal* is entirely consistent with the earlier fresh start cases discussed herein.

The Court then concluded that the loss-carryback refund claim was "sufficiently rooted in the pre-bankruptcy past and so little entangled with the bankrupts' ability to make an unencumbered fresh start that it should be regarded as property under Section 70a(5)".[41] Subsequently, this phrase has been cited and applied by this Court in deciding whether layoff or vacation pay, accrued but unpaid at the time of bankruptcy, passed to the trustee as "property" under Section 70a(5).

In *Lines v. Frederick,* 400 U.S. 18 (1970), an employee of a large manufacturing company had accrued lay-off pay of $137.28 at the time he filed his petition. He could collect this sum either during the annual period when his employer shut down the plant in which he worked, or on final termination of his employment. Also involved in this case was another employee, who had accrued vacation pay of $144.14 which he could draw either on termination or under a conventional voluntary vacation plan of his employer.

In deciding that the lay-off and vacation pay was not property within the meaning of Section 70a(5), the

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[40]382 U.S. at 379-380.

[41]*Id.* at 380.

Court inferred that the nature and relationship of the asset resembled future wages. The Court noted (at p. 20) that the debtors were wage earners whose sole source of income prior to and subsequent to bankruptcy was weekly earnings and that "the function of their accrued vacation pay is to support the basic requirements of life for them and their families during brief facation periods or in the event of layoff." Lastly, the Court suggested that "[T]he wage-earning bankrupt who must take a vacation without pay or forego a vacation altogether cannot be said to have achieved the 'new opportunity in life and [the] clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt', ... *Local Loan Co. v. Hunt, supra.*, which it was the purpose of the statute to provide."

This Court in *Lines* recognized *vacation* pay as having a unique function in that it was related to a short and determinable period of non-labor which would occur *after* bankruptcy. The Court focused on the vacation as a necessary event associated entirely with the post-bankruptcy future. One of the debtors in *Lines* was in fact forced to take a vacation, occasioned by an annual two week shutdown of his employer's plant. In his dissenting opinion, Justice Harlan noted that if the employee lost the lay-off pay which had accrued to the date of bankruptcy, he would have had only three days' pay coming when his employer shut down the plant. Thus, the Court treated vacation pay as analogous to the future wages at issue in *Hunt*, noting that if the bankrupts were forced to live through a post-bankruptcy vacation or lay-off period without pay, they would lack a "clear field for future effort".

C. The conflicting holdings of *Cedor*, *Kokoszka* and *Gehrig*.

The *Segal* and *Lines* decisions formed the central basis for several recent conflicting decisions dealing with income tax refunds,[42] which this Court is to resolve by its decision herein. As previously noted, it has been the general practice to include in the bankrupt's estate income tax refunds due at the time of bankruptcy.[43] Since the *Segal* and *Lines* decisions, this practice has been under attack. The conflicting approaches taken by the Second, Eighth and Ninth Circuits can be summarized as follows:

1. *In re Cedor*,[44] the Ninth Circuit held that:

(a) The portion of a refund attributable to minimum[45] withholding does not pass to the trustee and can be retained by the Bankrupt.

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[42]For general analysis and review of issues presented to this Court see Note, *The Income Tax Refund as a Possible Asset of a Wage Earner's Bankruptcy Estate*, 87 Harv. L. Rev. 395 (1973); Comment, *Title to Property - Employee Bankrupt's Income Tax Refunds*, 47 Am. Bankr. L.J. 239 (1973); Note, *Treatment of Income Tax Refunds in Bankruptcy After Lines v. Frederick*, 71 Mich L. Rev. 331 (1973); Note, *The Withholding Tax in the Bankruptcy Context*, _____ Brooklyn L. Rev. _____ (1974 - to be published).

[43]Note 36, *supra*.

[44]470 F.2d 996 (9th Cir. 1972).

[45]Minimum withholding means that the employee claimed the correct number of withholding exemptions on his IRS Form W-4 which he must execute upon beginning his employment. Income Tax Regulations, Section 31.3402(f)(2)-1. If his allowable exemptions increase during the course of his employment, he may execute another Form W-4; e.g., he marries, has a child, his itemized deductions increase, etc. See Section 3401(f)(1) of the Internal Revenue Code of 1954. The determination of the amount

(b) The portion of a refund attributable to optional[46] withholding is "property" which passes to the trustee pursuant to Section 70a(5), but only to the extent of 25% in accordance with the Consumer Credit Protection Act, Sections 1671-1677.

2. *In re Kokoszka,*[47] the Second Circuit ruled:

(a) An income tax refund, attributable to either minimum or optional withholding, is "property" within the meaning of Section 70a(5) and passes to the trustee.

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of withholding was changed by the Revenue Act of 1971. Public Law 92-178, 92nd Cong., 1st Sess., §208 (1971). These changes have been codified as Section 3401(f), *supra.* The reason for the amendments was to enable wage earners to have the correct amount of income tax withheld and avoid both the over and under withholding. See H. Rept. No. 92-533, 92nd Cong., 1st Sess., 1972-1 Cum. Bull. 518-520. However, a wage earner may still claim fewer than the maximum withholding exemptions permitted him under the statute. Also, he may unconsciously cause his employer to over-withhold if his allowable deductions increase measurably during the tax year and he does not increase his withholding exemptions. For example, a married wage earner with an income under $8,000 should claim one additional withholding allowance for each $750 of deductions which exceed $1,700, the base figure in the withholding tables. Therefore if his allowable deductions during the year are between $1,701 and $2,450, he should claim one additional allowance; if the amount of such deductions are between $2,451 and $3,200, he should claim two additional exemptions. If the correct number of withholding exemptions are claimed, neither over nor under withholding will occur assuming the wage earner works the entire year.

[46]Optional withholding occurs when a taxpayer claims fewer than his permitted withholding exemptions. See Section 3401(f)(1), *supra.* This action results in more income tax being withheld than is necessary.

[47]479 F.2d 990 (2d. Cir. 1973).

(b) Since such tax refund is not "earnings" for the purposes of the Consumer Credit Protection Act, the entire refund, rather than only 25%, belongs to the trustee.

3. *In re Gehrig*,[48] the Eighth Circuit concluded that:

(a) The portion of a refund attributable to minimum withholding does not pass to the trustee and can be retained by the bankrupt.

(b) To the extent that a tax refund may be attributable to the optional withholding by the debtor, it is "property" within the meaning of Section 70a(5) and the provisions of the Consumer Credit Protection Act do not apply to any portion of such refund.

It is difficult, if not impossible, to perceive any basis for the distinction drawn by the Eighth and Ninth Circuits between optional and minimum withholding. Certainly, the language of Section 70a(5) makes no such distinction. It would seem to follow logically that if a refund is due at the time of bankruptcy with respect to taxes withheld from wages paid prior to bankruptcy, whether such refund is the result of optional or minimum withholding should not answer the question whether it is "property" under Section 70a(5). If the refund is "property" because the debtor had his employer over withhold, it follows that it is also "property" if the employee claims the correct number of withholding exemptions because the test depends upon whether the refund claim is transferable by the debtor at the date of bankruptcy, and not whether voluntarily withheld as "forced savings" or involuntarily withheld as required by law.

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[48] 1974 CCH Bankruptcy Reports ¶65,116 (8th Cir. 1974).

D. Application of *Segal* and *Lines*.

As previously noted, there is nothing in the history or language of Section 70a to exclude a tax refund as "property". In fact, "it was the intent of Congress to secure to creditors all property of a bankrupt".[49] The laws of Connecticut do not exempt a tax refund as an exempt asset.[50] The tax refund is also assignable under Connecticut law.[51] Petitioner even admits that Connecticut law does not exempt wages.[52] Impliedly, Petitioner admits that the tax refund is not an exempt asset under the laws of the State of Connecticut; otherwise, there would be no reason to argue that this Court should decide that it is not "property" under Section 70a(5). In effect, this Court is being asked to create a Federal exemption that would exempt the tax refund, which tax refund would otherwise not be exempt under the laws of Connecticut.

In order for this Court to decide in Petitioner's favor, it must ignore the holding in *Legg v. St. John, supra*, as well as the meaning and application of Sections 70a(5) and 6 of the Bankruptcy Act. Moreover, the position urged by Petitioner would be extremely detrimental to the provisions of the practice under the Bankruptcy Act, because Sections 70a(5) and 6 would have a meaning wholly inconsistent with long standing interpretations by this Court and lower courts which must supervise bankruptcy proceedings daily.

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[49] *Segal v. Rochelle*, at 379.

[50] See §52-352 of the laws of Connecticut.

[51] 479 F.2d at 993; this fact is not in dispute.

[52] Brief for Petitioner at 19-20.

Basically, Petitioner is requesting this Court to rest such a decision on the holding of *Lines v. Frederick, supra.* Petitioner's interpretation of the *Lines* decision disregards the meaning and application of the fresh start doctrine, and ignores the point that lay-off and vacation pay were considered by this Court equivalent to post-bankruptcy wages. Once Petitioner's analysis of *Lines* is rejected, he is left without any legal argument that the refund is not property under Section 70a(5). The following quote from the opinion of the Bankruptcy Judge ably explains the nature of an income tax refund and demonstrates why it is property within the meaning of Section 70a(5):

> "... First, wages are withheld under federal law for application on an eventual tax liability and are paid to and become the property of the government. Second, the wages are not withheld for taxes under any designed program that they or any portion of them shall be returned to the bankrupt to insure his future support when he is without daily earnings. Third, a claim to a refund arising out of taxes voluntarily or involuntarily paid out of wages is quite the equivalent of savings accumulated by a bankrupt out of his yearly earnings and any such savings held by a bankrupt at bankruptcy – whether in the form of cash in a safe deposit box or in a bank account – became the property of the bankruptcy estate. Fourth, a claim to a refund is not distinguishably different from any other property of property right which a bankrupt might have acquired by using a portion of his annual wages to make a loan to another, to buy securities or to acquire an automobile, all of which pass to a trustee in the event of bankruptcy. Accordingly, it is the view of this court that a claim to a tax refund for excess taxes paid from

wages is quite something different from a right to receive accumulated wages in the future which were specifically designed to substitute for future lack of earnings. The concept of *Lines* is not applicable to a tax refund. Such a refund is a property which passes to a trustee in bankruptcy under section 70a(5). (App, at 7-8).

Apart from ignoring the differences between an income tax refund and the accrued vacation pay at issue in *Lines*, Petitioner overemphasizes the importance that an income tax return has an origin in the bankrupt's wages and deserves special protection.

In support of this position, Petitioner cites *Sniadach v. Family Finance Corp.*, 395 U.S. 337 (1969); *James v. Strange*, 407 U.S. 128 (1972); *Fuentes v. Shevin*, 407 U.S. 67 (1972); *Lynch v. Household Finance Corp.* 405 U.S. 538 (1972), None of these causes concerned the issue presented before this Court. These respective decisions address other problems unassociated with the Bankruptcy Act and the interplay between Section 70a(5) and Section 6. Petitioner advanced the same argument before the Court of Appeals that wages are a specialized type of property. The appellate tribunal properly answered this contention as follows (p. 995):

> "... Just because some property interest had its source in wages, however, dos not give it special protection, for to do so would exempt from the bankrupt estate most of the property owned by many bankrupts, such as savings accounts and automobiles which had their origin in wages."

The Sixth Circuit was faced directly with the issue of whether wages earned prior to bankruptcy should be

given special protection under the Bankruptcy Act.[53] In that factual situation, the bankrupt had earned wages prior to bankruptcy which were unpaid at the date of his bankruptcy filing. The Sixth Circuit determined that wages not exempt under the laws of Ohio constitute property which should go to the trustee, relying upon the test set forth by this Court in *Segal v. Rochelle, supra,* and noted that the concept of a "fresh start" should not be judicially expanded to include "property" which would otherwise vest in the trustee.

Once *Lines* is limited to its own special facts, the criteria for including the income tax refund within the bankruptcy estate is whether the refund is "sufficiently rooted in pre-bankruptcy past", the tax refund in issue represented taxes withheld from wages earned by Petitioner prior to his filing for bankruptcy. The tax refund is not the equivalent of future wages and does not relate in any way to future wages.[54] At the end of each year, most wage earners must file a United States Income Tax Return.[55] Generally, the person either (1

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[53] *In re Aveni,* 458 F. 2d 972 (6th Cir.), *cert. denied,* 409 U.S. 877 (1972).

[54] 379 U.S. at 375: "Accordingly, future wages of the bankrupt do not constitute property at the time of bankruptcy. . . . "

[55] An unmarried taxpayer with gross income in excess of $2,050.00 and married taxpayers, filing a joint return, with combined gross income in excess of $2,800.00 must file income tax returns. See Section 6012(a) of the Internal Revenue Code of 1954. However, those persons earning less may still file a return in order to claim a refund. This is what Petitioner did. He and his wife filed a joint return showing income of $2,322 and claimed a refund of the entire amount withheld from his wages ($250.90). Appendix, page 19.

pays no additional tax because the amount withheld equals the income tax due; (2) receives a tax refund because the amount withheld exceeds the income tax due; or (3) he must pay more tax because the income tax due exceeds the amount withheld. In the instant case, the bankrupt filed his petition on January 5, 1972, and at that time had a right to a refund for 1971 because he did not earn enough to pay any tax.[56] During 1971, Petitioner earned $2,322.00, and his employer withheld $250.90 based upon two withholding allowances claimed by the bankrupt.[57] On January 5, 1972, the date the bankruptcy petition was filed, Petitioner had a right to claim a refund from the United States Government for taxes paid during 1971.[58] It is apparent, therefore, that the refund of 1971 taxes is "sufficiently rooted in the pre-bankruptcy past" of Petitioner and certainly not "future wages" which would not be an asset of the bankrupt of the date of bankruptcy.

In *Segal*, this Court determined that transferring the tax claim to the trustee did not hinder the bankrupt from starting out on a "clean slate".[59]

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[56]Mr. Kokoszka was employed for approximately three months during 1971. See Brief for Petitioner at 2.

[57]On or before the date an individual commences employment, he must execute a withholding exemption certificate (Form W-4), listing the number of withholding exemptions which he claims. See Section 3402(f)(2) of the Internal Revenue Code of 1954; Income Tax Regulations Section 31.3402(f)(2)-1. See Brief for Petitioner at 2-3.

[58]After December 31, 1971, Petitioner's 1971 taxable year ended, and he was then entitled to any refund for 1971. Petitioner filed a joint income tax return in mid-February 1972, and the refund check was received a short time later.

[59]382 U.S. at 380.

The Petitioner perceives "similarities"[60] between the accrued vacation issue in *Lines* and the tax refund question before this Court. The fact of the matter is that the income tax refund:

1. Relates solely to pre-bankruptcy earnings "sufficiently rooted in pre-bankruptcy past";[61]

2. It is not created out of "future wages"[62] but rather was withheld from pre-bankruptcy earnings;

3. Is a vested right in existence at the time of filing the petition;[63]

4. Is not an exempt asset under the laws of the State of Connecticut;[64]

5. Has traditionally been made available to creditors in accordance with long-standing practice throughout the bankruptcy courts of the United States;[65]

6. Does not deprive the Petitioner of a "fresh start" or "new opportunity in life" consistent with previous decisions.

If in 1971 Petitioner had loaned $250.59 to a third party and had gone into bankruptcy on January 5, 1972, (as he did), clearly that loan would have been a receivable due him and listed on Schedule B-2 (Personal Property) of his Bankruptcy Petition. It cannot be seriously questioned that this receivable would not have

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[60]Brief for Petitioner at 8-10.

[61]*Segal v. Rochelle, supra.*

[62]*Local Loan Co. v. Hunt, supra.*

[63]Note 12, *supra.*

[64]Note 50, *supra.*

[65]Note 36, *supra.*

been an asset of the bankruptcy estate, i.e., "property" within the meaning of Section 70a(5). However, the effect of Petitioner's argument to this Court is that the loan receivable should not be deemed "property" because the debtor needs those funds for a "fresh start". Under this argument, the determination of what is "property" would be based on how much money the debtor needed in the future. It is suggested that the income tax refund in other cases could be as much as $1,000.[66]

The Bankruptcy Act objectives, "clean slate", "unencumbered fresh start", "new opportunity in life" and "clear field for future effort" enunciated in pre *Hunt cases, Hunt, Legg, Segal* and *Lines,* are not circumscribed by the tax refund going to the trustee. The discharge of Petitioner's $6,105.22 pre-bankruptcy unsecured debts, satisfies those objectives.

Certainly, Petitioner's income tax refund in the amount of $250.59 would help the debtor to pay for post bankruptcy medical or other expenses. However, the present Bankruptcy Act does not exempt "property" because the bankrupt could use money to pay personal expenses. The proposed Bankruptcy Act, discussed *infra* would permit Kokoszka, and other debtors, to retain up to $500 of an income tax refund.

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[66]Brief for Petitioner at 17. On March 26, 1974, Donald C. Alexander, Commissioner of Internal Revenue, announced that the average refund was $345 for all tax returns processed to date. See "I.R.S. Expects to Step Up Tax Audits". New York Times (March 27, 1974).

III.

THE EXEMPTION OF THE INCOME TAX REFUND FROM THE BANKRUPT'S ESTATE IS BEING CONSIDERED BY THE CONGRESS.

A. Bankruptcy Commission.

There is pending before the Congress the most sweeping bankruptcy legislation since the Chandler Act was enacted in 1938.[67] On July 30, 1973, the Commission on the Bankruptcy Laws of the United States, pursuant to its legislative charter, transmitted to the President, the Chief Justice, and the Congress its Report, consisting of two principal parts, an analysis and evaluation of the present system of bankruptcy administration in the United States and recommendations for changes, including a new Bankruptcy Act.[68]

B. Legislative Recommendations.

The legislation, introduced in both Houses of the Congress and entitled the "Bankruptcy Act of 1973" was assigned to the Committees on the Judiciary in the House and Senate. As yet, neither Committee has held extensive hearings, and it is not expected that the legislation will be voted upon in either the House or the Senate by the end of this year. Presumably, the

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[67]H.R. 10792, 93rd Cong., 1st Sess., introduced October 9, 1973; S. 2565, 93rd Cong., 1st Sess., introduced October 11, 1973.

[68]The Bankruptcy Commission was created by Senate Joint Resolution No. 88, 91st Congress (Public Law 91-354. July 24, 1970), and its members were appointed by the President, the Chief Justice, President of the Senate and Speaker of the House.

legislation will be reintroduced next year and considered by the Ninety-Fourth Congress.

In Chapter 7 of its Report, the Commission addresses the subject of exemptions and suggests that they are of particular importance to the consumer debtor.[69] The major complaint voiced by the Commission is that the present Act defers to state laws for what is exempt and this has resulted in a lack of uniformity of treatment of creditors and debtors.[70] It proposes to solve this problem by legislating the exemptions as a part of the new Bankruptcy Act. The following quote sums up the Commission's approach to exemptions:

> "The Commission recommends that kinds of property that traditionally have been treated as exempt by state governments form the nucleus of the federal exemptions with appropriate federal maximums. This approach avoids the unfairness of existing state exemptions laws, most of which are archaic, some of which are unduly generous and some of which are exceedingly niggardly, particularly as to urban residents. . . ."[71]

Specifically, the exemptions include, among other items not relevant, "Cash, securities, and receivables, including unpaid personal earnings, accrued vacation pay, and income tax refund, to the aggregate value of not more than $500.[72] In discussing the proposed statutory language, the Commission suggests that these assets,

[69]Report of the Commission on Bankruptcy Laws of the United States (hereinafter cited as Bankruptcy Report), Part I, at 169.

[70]*Id.*

[71]*Id.*, Part I, at 171.

[72]This provision is found in Section 4-503(c)(3) of H.R. 10792, *supra* note 67, at 120, and the same Section in S. 2565, *supra* note 67, at 114-115. Of course, it depends on the particular law of the state where the debtor resides whether an income tax refund is exempt. See Vukowich, *Debtor's Exemption Rights*, 62 Geo. L.J. 779, 829-830 (1974).

including an income tax refund, are often exempt under state laws.[73] Implicit in this analysis of the current Bankruptcy Act is that such asset is property within the meaning of Section 70a(5); otherwise, it would make no difference to propose to exempt it. Also, it must be stressed that the interpretation given the exemption provision of Section 6 is that state law governs whether an income tax refund is exempt. Both of these conclusions by the Commission are supported by the cases and legislative history cited earlier in the Brief.

The Report also recommends that "property of the estate" be defined in the proposed Bankruptcy Act and that "the tests of transferability and leviability under state law be abandoned."[74] Primarily, the Commission focuses on the requirement of the present Act that local law govern not only what is "property of the estate" but also the question whether property is voluntarily or involuntarily transferable.[75] The reference to state law to determine whether property is transferable, in the opinion of the Commission, is unnecessarily productive of litigation and produces a lack of uniformity.[76] The Commission interprets Section 70a(5) to cover property "which prior to the filing of the petition [the debtor] could by any means have transferred or which might have been levied upon and sold under judicial process against him, or otherwise seized, impounded, or sequestered".[77]

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[73] Bankruptcy Report, Part II, at 128.

[74] *Id.*, Part I, at 17.

[75] *Id.*, Part I, at 193.

[76] *Id.*

[77] *Id.*

The proposed statutory language would streamline the definition of "property of the estate" as all property of the debtor as of the date of the petition, with exceptions not material herein, together with certain other property which can be recovered from third parties.[78] In any event, reference to state law, even under the proposed Bankruptcy Act, will still be necessary to determine what is the "property" of the debtor, and the Report suggests that "this reference has not proved too troublesome, and what difficulty it may create is far over-shadowed by the difficulty of codifying rules of property solely for the purpose of bankruptcy administration".[79]

After an exhaustive two year study of the present Bankruptcy Act, the Bankruptcy Commission, its staff and consultants, comprising the most knowledgeable and able bankruptcy scholars in the country, has concluded that the present Act does not produce uniformity, an essential ingredient of a national bankruptcy act, with respect to either what is "property of the estate" under Section 70a(5) or what property, which would otherwise be part of the bankruptcy estate, is exempt.[80] As discussed above, the answers to those questions hinge on the state laws of the jurisdiction where the debtor files his petition. The changes proposed by the Bankruptcy Commission would incorporate in the Bankruptcy Act itself the definition of "property of the estate" and the exemptions which would be allowed.

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[78]Section 4-601(a) of H.R. 10792, *supra* note 67, at 135-137, and S. 2565, supra note 67, at 130-131.

[79]Bankruptcy Report, Part I, at 194.

[80]*Id.*, Part I, at 169, 193.

Certainly, the findings of the Bankruptcy Commission are entitled to great weight. The interpretation given Section 70a(5) of the Bankruptcy Act is that all property which could by any means have been transferred is property of the estate. This would include an income tax refund which could have been applied for by the debtor on the date of bankruptcy. Obviously, such an asset would not have been exempted by the Commission in the new Act unless it was property of the estate.[81]

In this proceeding, Petitioner is asking this Court to judicially amend the present Bankruptcy Act to either (1) determine that an income tax refund is not "property" within the meaning of Section 70a(5) or (2) decide than an income tax refund is "exempt" without reference to Section 6 of the Bankruptcy Act and the laws of Connecticut. It would seem that the exhaustive study and proposed Bankruptcy Act of the Commission on the Bankruptcy Laws of the United States, which is presently pending before the Congress, offers a more preferable and traditional way of considering amendments to the present Bankruptcy Act, and more particularly, when the changes sought by Petitioner would require a new approach to deciding what is "property" and what property is exempt, both fundamental questions under the Bankruptcy Act.

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[81]The new definition of "property of the estate" combines in part, present Sections 70a(5) and (6) so that "property" for purposes of the new act would not be different with respect to covering an income tax refund. See Bankruptcy Report, Part II, 148-149.

IV.

THE CONSUMER CREDIT PROTECTION ACT DOES NOT PRECLUDE THE TRUSTEE FROM OBTAINING THE ENTIRE INCOME TAX REFUND WITHIN THE BANKRUPTCY ESTATE.

Petitioner contends[82] "that the income tax refund, even if it is 'property', is entitled to the 75% exemption enjoyed by all other wage payments under the provisions of the Consumer Credit Protection Act ("CCPA").[83] Petitioner bases his argument on Section 6 of the Bankruptcy Act, which does not affect the allowance to bankrupts of exemptions which are prescribed by the laws of the United States. Petitioner relies upon definitions contained in Section 1672 of the CCPA.[84] Petitioner argues that a tax refund is "earnings" because the refund consists entirely of compensation payable for personal services and that when the refund is returned to the Petitioner it is

[82]Brief for Petitioner at 28.

[83]15 U.S.C. §1671-1677.

[84]15 U.S.C. §1672. Definitions, provides:

"For the purposes of this subchapter:

(a) The term 'earnings' means compensation paid or payable for personal services, whether denominated as wages, salary, commission, bonus, or otherwise, and includes periodic payments pursuant to a pension or retirement program.

(b) The term 'disposable earnings' means that part of the earnings of any individual remaining after the deduction from those earnings of any amounts required by law to be withheld.

(c) The term 'garnishment' means any legal or equitable procedure through which the earnings of any individual are required to be withheld for payment of any debt."

"disposable" earnings because nothing is required by law to be deducted or withheld from these earnings. Petitioner, therefore, contends that the taking of the tax refund is a "garnishment" because the bankruptcy proceeding is a legal or equitable procedure through which the earnings of an individual are withheld for payment of a debt. These same contentions were asserted before the Appellate Court which held[85] that a tax refund is not "earnings" for the purposes of §1673 and therefore it is not protected by §1673.[86] The Appellate Court reasoned that the intent of the CCPA

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[85] 479 F. 2d at 996-997. *In re Gehrig*, note 48, *supra*, concurred with the ruling of the 2nd Circuit and disagreed with *In re Cedar* note 44, *supra*, which held to the contrary.

[86] §1673. "Restriction on garnishment – Maximum allowable garnishment

(a) Except as provided in subsection (b) of this Section and in Section 1675 of this title, the maximum part of the aggregate disposable earnings of an individual for any workweek which is subjected to garnishment may not exceed

(1) 25 per centum of his disposable earnings for that week, or

(2) the amount by which his disposable earnings for that week exceed thirty times the Federal minimum hourly wage prescribed by Section 206(a)(1) of Title 29 in effect at the time the earnings are payable, whichever is less. In the case of earnings for any pay period other than a week, the Secretary of Labor shall by regulation prescribe a multiple of the Federal minimum hourly wage equivalent in effect to that set forth in paragraph (2).

Exceptions

(b) The restrictions of subsection (a) of this Section do not apply in the case of

(1) any order of any court for the support of any person.

(2) any order of any court of bankruptcy under chapter XIII of the Bankruptcy Act.

(3) any debt due for any State or Federal tax."

was to make certain that wage earners were able to receive at least 75% of their take home pay in any one period, so that they would have enough cash to meet basic needs. The Court concluded that it was clear from the language of Sections 1672 and 1673 and the legislative intent thereof, that "earnings" means periodic payments of compensation and does not pertain to every asset that is traceable in some way to such compensation.

Once again, legislative history is helpful in establishing the intent of Congress in enacting Title II "Garnishment" of the CCPA. In House Report No. 1040,[87] the Committee on Banking and Currency noted that restricting garnishment of wages had the following purposes:

> "Title II restricts the garnishment of wages, which the Committee finds to be a frequent element in the predatory extension of credit, resulting, in turn, in a disruption of employment, production and consumption."

In further analyzing the restriction of garnishment of wages embodied in Title II, the Committee stated at 1963:

> "While consumer credit has enjoyed phenomenal growth over the past twenty years, so have personal bankruptcies. Title II of your Committee's bill, restricting the garnishment of wages, will relieve many consumers from the greatest single pressure forcing wage earners into bankruptcies."

Additionally, in the Committee Report under the heading entitled, "What the Bill Would Do", the

[87] H. Rept. No. 1040, 90th Cong., 2nd Sess., 2 U.S. Code, Cong. & Adm. News, 1963 (1968).

Committee stated that "Title II is concerned with mitigating the harsh and burdensome effects on both employers and employees of the garnishment of employees' wages".[88] This statement further emphasizes that the Committee was notably concerned with the disruptive effects on employers and employees when an employee's wages were garnished by a creditor.

The Committee further reiterated its concern of employees' wages being garnished in that the Committee "finds that the garnishment of wages is frequently an essential element in the predatory extension of credit resulting in a disruption of employment, production, as well as consumption."[89] A further indication of the clear cut purpose of the garnishment restrictions is reflected by the Committee when it stated that: "Your Committee has adopted an amendment . . . prohibiting an employer from discharging an employee by reason of a single garnishment of the employee's wages."[90] Noting that Title II had received endorsement from trade unions and industrial groups, the Committee stated:

> "The limitations on the garnishment of wages adopted by your committee, while permitting the continued orderly payment of consumer debts, will relieve countless honest debtors driven by economic desperation from plunging into bankruptcy in order to preserve their employment and insure a continued means of support for themselves and their families."

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[88] *Id.*, at 1966.

[89] *Id.*, at 1977.

[90] *Id.*, at 1978-1979.

It is apparent that the Committee was genuinely concerned about the undesirable consequences of unrestricted garnishments being placed with an employer which in turn could result "in economic desperation plunging an employee into bankruptcy".[91]

In addition to the intent of Congress expressed in the Committee Report, this same intent is clearly reflected in the Congressional findings and declaration of purposes in Section 1671(a)(1) and (2) of the CCPA.

> "(1) The unrestricted garnishment of compensation due for personal services encourages the making of predatory extensions of credit. Such extensions of credit divest money into excessive credit payments and thereby hinder the production and flow of goods in interstate commerce."
>
> "(2) The application of garnishment as a creditors' remedy frequently results in loss of employment by the debtor, and the resulting disruption of employment, production, and consumption constitutes a substantial burden on interstate commerce."

That "extensions of credit", "loss of employment", and "disruption of employment" refer to an ongoing employer-employee relationship is most apparent. Title II of the CCPA was intended to protect the employment of a debtor when his employer had been named in a garnishment proceeding and the employee's wages were sought to be garnished. The legislative history of the CCPA and the specific statutory language clearly manifest an intent to regulate garnishment in its usual and accepted sense – employer-employee relation-

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[91] *Id.*, at 1979.

ship. Title II gives no suggestion that a different purpose was intended and there is nothing in the Act which provides or supports a contrary conclusion. If anything, the main objective of the CCPA was to keep wage earners out of bankruptcy and once bankruptcy has occurred, the CCPA was not intended to protect the bankrupt.

The Appellate Court correctly held that the Act was clearly intended to protect only compensation made in the form of periodic payments to support a wage earner's family and was not designed to pertain to every asset traceable to wage compensation. This is particularly true when a bankruptcy occurs since the income tax refund has no relationship to the bankrupt's receiving compensation directly from his employer in support of his family. An income tax refund does not fall within the definition of "earnings" or "disposable earnings".

Despite the fact that the trustee is "vested by operation of law with the title of the bankrupt as of the date of the filing of the petition initiating a proceeding", such a vesting is not within the definition of "garnishment", i.e., a "legal or equitable procedure through which earnings of any individual are required to be withheld for payment of any debt". Furthermore, the assertion by Petitioner that the Referee's turnover order comes within the CCPA requires little comment since such order is authorized and required by the provisions of the Bankruptcy Act, which provisions are directed at marshalling the assets of the bankrupt and not placing a garnishment with his employer. Finally, but most importantly, the overriding purposes of the

Bankruptcy Act are ignored by Petitioner.[92] If this Court accepts Petitioner's argument that the CCPA applies to a tax refund and thereby precludes the trustee from obtaining all of the refund, it will ignore the Bankruptcy Act.[93] There is nothing in the Bankruptcy Act which even remotely reflects such an intention, nor is there anything in the CCPA which likewise makes such an assumption.

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[92]15 U.S.C. §1673(b)(2) provides: "The restrictions of subsection (a) of this Section do not apply in the case of . . . any order of any court of bankruptcy under Chapter XIII of the Bankruptcy Act." Chapter XIII of the Bankruptcy Act is designed to rehabilitate debtors through Wage Earners Plans, so that straight bankruptcy can be prevented. Since normally debtors would pay their creditors through their wages, the CCPA was designed not to affect this objective. There is nothing, however, to suggest that Congress intended to make applicable the CCPA to straight bankruptcy.

[93]Additionally, the Secretary of Labor's position (Petitioner's Brief, p. 36) is not supported by the history of the CCPA. Likewise, it is contrary to the basic provisions of the Bankruptcy Act.

CONCLUSION

For the foregoing reasons, the decision of the Circ
Court of Appeals should be in all respects affirmed.

Respectfully submitted,

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